NATIONAL FORECAST DESCRIPTION

The Forecast Period is the First Quarter of 2001 through the Fourth Quarter of 2004

It appears that Dr. Greenspan's patient is sicker than had originally been diagnosed. In January 2001, it was believed the U.S. economic slowdown would be mild and that the economy would enjoy a speedy recovery. Although down from 2000's healthy performance, real GDP growth was still expected to advance 3.6%--near its potential. It was projected to pick up speed to 4.3% in 2002 and 4.8% in 2003, then settle back to 3.8% in 2004. The economy's prognosis was downgraded last spring. In the July 2001 forecast, real GDP manages to grow just 1.7%--which is less than half of what was expected in January 2001 and well below its potential. Despite this setback, forecasters still believed the economy would make a quick and full recovery. Real GDP would be back on its feet in no time; it would expand 3.3% in 2002, 4.4% in 2003, and 4.0% in 2004. After consulting their charts, forecasters now believe the economy is in for a protracted convalescence. The April 2001 forecast shows real GDP experiencing sub-par growth throughout the forecast period.

The economy's current condition has been labeled a "U" Scenario. This is because the slow decline in real GDP and gradual recovery resembles the 21st letter of our alphabet. Of course, it may be worthwhile to get a second opinion. Indeed, other outcomes are also possible. We consider three that contribute to our alphabet soup of scenarios.

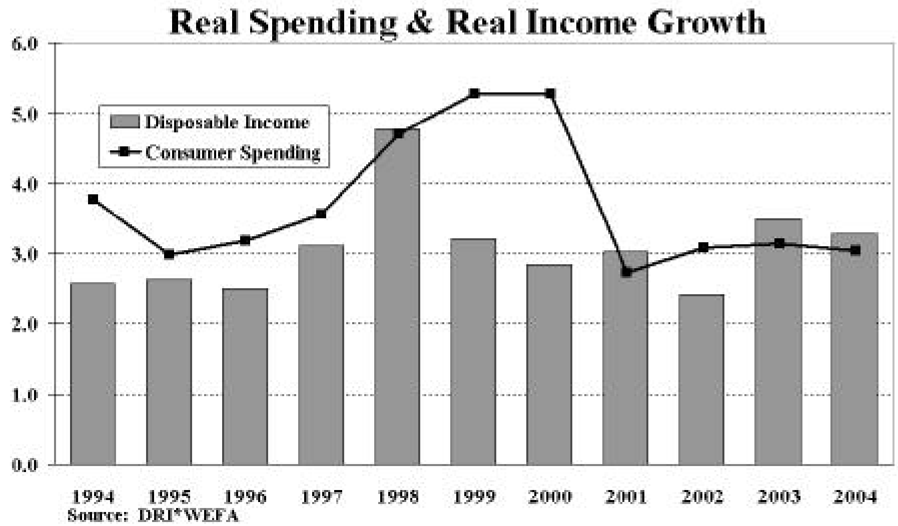
There is still a chance the economy could recover quicker than is being forecast. A key ingredient for this kind of recovery is for a quick end to the high-tech slump. This would allow for a rebound in business investment and a return to higher productivity growth rates. This recovery would also be helped by stronger demand. This could happen if consumers spend their federal tax rebates more freely than had been anticipated. Inflation should not be a problem in this scenario because the worldwide excess of manufacturing capacity should help keep prices in check. Not surprisingly, this has been labeled the "V" Scenario.

One of the concerns is that the "V" Scenario could turn into a "W" Scenario. As its name implies, the quick strong recovery would be followed by another economic downturn. In some respects it is like the "V" Scenario. However, growth in the U.S. and the rest of the world is considerably stronger and synchronized. The stronger demand is enhanced by the federal tax rebates. The labor market remains tight. Unfortunately, productivity growth languishes. The combination of a stronger labor market and poor productivity growth cause unit labor costs to soar. High energy prices add further fuel to inflation. The Federal Reserve tightens in response, and this causes the economy to falter.

But the "W" Scenario is not as bad as the "L" Scenario. In this case, the economy falls into a funk it is unable to shake. Several factors contribute to this scenario. Global imbalances take longer to work out. High levels of U.S. indebtedness constrain growth. Productivity growth fizzles out. The energy crisis spreads. As a result, the United States suffers through an extended period of stagflation. The major risk in this scenario is that prolonged investment busts combined with stock market collapses have resulted in "lost decades." An example of this would be Japan's economic doldrums since the 1990s.

While the U.S. economy is expected to perform below par over the next few years, its condition is far from terminal. Under current conditions, the nation's economy is projected to slow, but not decline. It should gradually pick up speed after 2001, but this growth is expected to be less than experienced in the latter 1990s and below its potential.

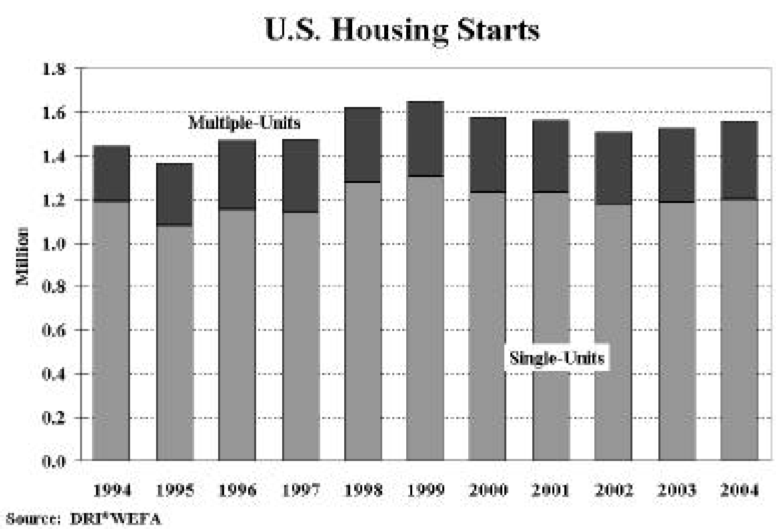
SELECTED NATIONAL ECONOMIC INDICATORS



Consumer Spending: Whether the U.S. economy suffers a recession in the next few months, hinges on how well the consumer sector performs. Should American consumers develop a bout of cold feet, the end to the record economic expansion may indeed be near. However, this is not likely to be the case. Recent history has shown that American consumers have grown resilient to factors that in the past would have curtailed their spendthrift ways. This resilience has kept the economy from breaching a recession's event horizon. One must go back to the end of the 1990-91 recession to see how creative consumers have been in order to continue their nearly decade-long shopping spree. Soon after the last economic downturn, consumers were anxious to make up for lost ground. They spent eagerly to make purchases, especially of large-ticket items, that had been postponed. Thus, real consumer spending rose nearly 2.9% in 1992, after experiencing less than 2.0% growth in 1990 and virtually no growth in 1991. After plummeting more than 6.0% in 1991, real spending on durable consumer goods advanced over 5.0% in 1993. As time passed, the spending continued to soar. By 1993, consumers were spending money faster than they were making it—a reversal of the previous two years when income growth out paced spending growth. In an effort to finance their spending, consumers turned to their savings. This was a logical choice; fears during the recession had curbed spending, which helped to fatten savings accounts. The U.S. personal savings rate actually dimbed from 7.8% in 1990 to 8.7% in 1992. Since then it has declined steadily, and by 2000 it was slightly negative. In fairness, unbridled spending was not the sole reason for this decline. The stock market grew strongly during the second half of the 1990s. As household asset values swelled, the need to "set aside something for the future" decreased, and this also contributed to the decline in the personal savings rate. When tapping their savings accounts did not provide enough to finance expanded spending, consumers took on more debt. This can be seen by comparing the ratio of nonmortgage consumer credit to disposable income over time. In 1992, this ratio was 16.5%, which is well below its long-term average of 18.9%. But in three years, it was well above the average at 20.2%. It has continued to grow steadily since then, hitting 22.0% in 2000. Consumers' willingness to take on greater levels of debt parallels the increase in consumer confidence during this time. Bolstered by strong job and stock markets and low inflation and interest rates, consumer confidence climbed steadily to a record of 110.1 in the first quarter of 2000. However, it retreated slightly in the following few quarters. It then dropped to below 100 in the first quarter of 2001 for the first time in four years. This decline reflected consumers concerns about the cooling economy and the stock market turmoil. It should be pointed out, while consumer confidence is lower than it was the same time last year, it is still above average. In addition, recent monthly data suggest consumers' moods have been improving recently. This positive outlook will help consumer spending move ahead. The federal income tax rebate should also boost spending in the latter part of this year. As consumers max out their credit cards and attempt to rebuild savings, real consumer spending is expected to grow more in line with real disposable income. <u>Specifically, real consumer spending should advance 2.7% in 2001, 3.1% in 2002, 3.1% in 2003, and 3.0% in 2004.</u>

Financial: The nation's central bank fired its latest shot in the battle to revive the floundering economy on June 27, 2001. Citing declining profitability and business capital spending, weak consumer spending, and slow growth abroad, the Federal Reserve announced that it was lowering its federal funds rate target by 25 basis points, from 4.0% to 3.75%. This marked the sixth decrease since the beginning of this year, and the federal funds rate is at its lowest level in seven years. What remains to be seen is when the Federal Reserve will stop lowering short-term interest rates. Several factors suggest we may be nearing that point. The 25-basis-point decrease was the smallest this year. While the Federal Reserve may not yet be done tapping on the brakes, it does appear to be letting up on the gas. There is some evidence the economy is stabilizing. In fact, on the same day the Federal Reserve was making its most recent cut, the *Wall Street Journal* reported consumer confidence, new home sales, and durable goods orders were improving. Even in the trough of the last recession, the federal funds rate was only down to 3.0%. In this forecast, it is assumed the Federal Reserve will cut the federal funds rate by another 25 basis points to 3.5% later this year. It will then take a wait-and-see approach, and leave the federal funds rate at this level through most of next year. The central bank is not expected to raise rates again until the last quarter of 2002. The outlook for the federal funds rate and several other key interest rates are illustrated in the accompanying chart.

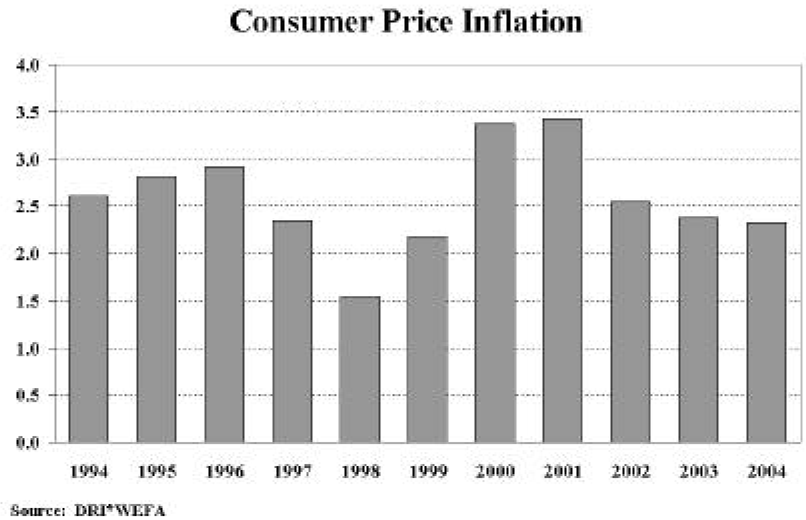
Housing: The future of the U.S. housing sector has been clouded by conflicting reports. Some data show this sector, which has shown remarkable longevity, may finally be feeling the pinch of the cooling economy. Total housing starts declined 3.4% from January 2001 to April 2001. This drop was entirely concentrated in multi-family units, which dropped an astonishing 15%. Single-family starts actually increased 6.7% over the same period. Not all the news about single-family housing was positive, however. For example, sales of new one-family homes were down 10% in April 2001 compared to March 2001. Existing single-family sales slumped in April as well, falling 4.2%. Meanwhile, new housing permits dropped 2.5% in April 2001, resulting in a three-month slide. Other data suggest the situation may not be as negative. Housing sales, starts, and permits all experienced a strong boost at the beginning of this year thanks to low mortgage interest rates. And it should be pointed out that housing sales and starts remain historically high despite remaining below their 2000 peaks. Indeed, existing single-family homes sold at a 5.2-million-unit



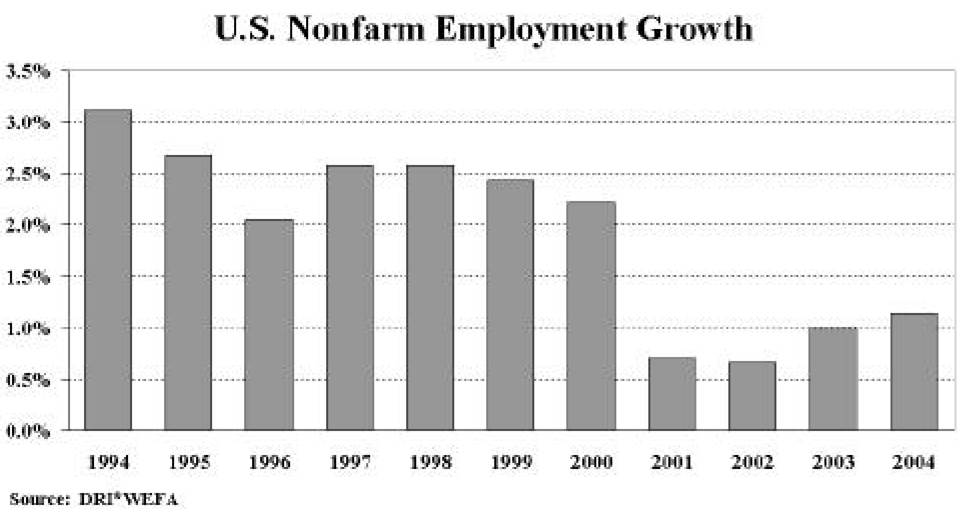
annual pace in April, which was 1.6% above their 2000 average. Single-family housing starts in April were 4.5% above last year's average. The mixed signals in the recent data suggest the housing sector, while softening, remains at high levels of activity. This also summarizes the outlook for this sector. Slackening economy and falling consumer confidence should gradually offset the boost from low mortgage interest rates. U.S. housing starts are forecast to fall 0.8% this year and 3.6% next year, then they grow 1.2% in 2003 and 2.1% in 2004. Thus, the housing sector should be a slight drag on the economy over the next two years.

International: The economic fortunes of the United State's trading partners will vary by how dependent they are on exports. Obviously, those that will be hardest hit by the cooling of the U.S. are regions like Asia whose economies depend heavily on imports to the U.S. The United States and Asia together accounted for 50-75% of Asia's exports. Thus, it will be impacted by an economic slowdown in the U.S. Due to Asia's significant inter-regional trade, there is a danger that its weakening domestic demand could create a vicious cycle, in which slowing domestic demand and exports reinforce each other. Japan's expected lackluster growth will provide little support in Asia. The signs of slowing are already surfacing. Excluding Japan and China, Asia's industrial production growth has slowed markedly since last year, from 16.7% in August 2000 to 4.6% in December 2000. Much of this decline has been due to sagging export growth. In fact, the rate of Asia's export gains plunged in late 2000, from around 26.0% in August to 6.0% in December. Europe should fare better because its trade patterns are more interregional than Asia's. Thus, while this region's growth is also expected to slow, it will not be as noticeable as in Asia. In fact, for the first time since 1991, Europe is expected to grow faster than the U.S. in 2001 and 2002. Closer to home, Canadian economic growth, while slower than it pace in 2000, should also be higher than in the U.S. The outlook is considerably weaker for Mexico and South America (Argentina, Brazil, Chile, Columbia, Ecuador, Peru, and Venezuela). Mexico is expected to struggle through this year and eke out just 2.9% real GDP growth. This is a significant slow down from the previous year when the Mexican economy expanded by a healthy 6.9%. It is anticipated that South America will advance just 2.1% this year. Both the Mexican and South American economies will pick up steam next year. Mexico's economy should grow 4.8%, while the South American economy should rise 3.0%.

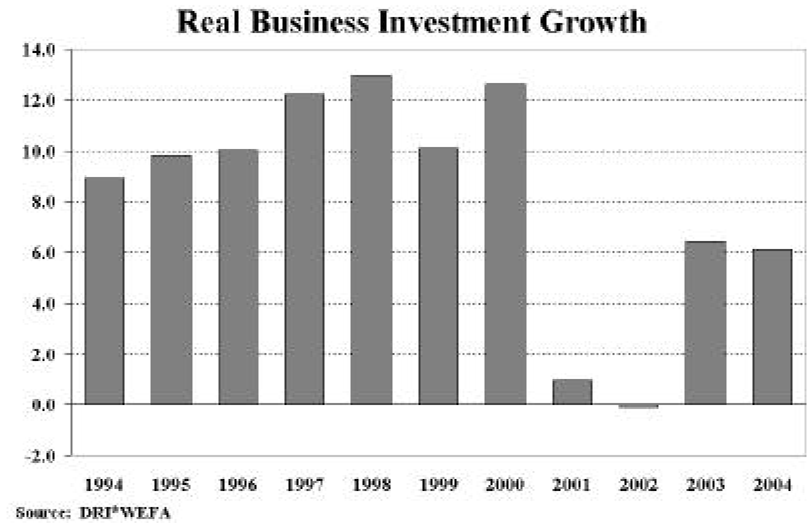
Inflation: There appears to be little danger of inflation re-igniting, despite recent price increases. Recent data indicate we are on the downhill slope of an inflation peak. The producer price index (PPI) for finished goods rose a seasonally-adjusted 0.3% in April 2001. But there is evidence inflation is decelerating. For the 12 months through April finished good prices were up 3.7%, but down from year-over-year rates recorded for January and February of 2001. Like the finished goods index, the consumer price index (CPI) rose 0.3% in April. This was quicker than in March, although the year-over-year increase of 3.3% was generally smaller than the gains posted over the prior six months. Other encouraging news comes from the National Association of Purchasing Managers (NAPM) and import prices. The NAPM reported prices paid by manufacturers fell for the third straight month in May 2001. For the 12 months ended in April, import prices are down 0.7%. Slower domestic growth, declining energy prices, rising unemployment, and excess manufacturing capacity worldwide all point to slower price escalation in the months ahead. Downstream inflation should be limited by the benign producer level inflation. Producer price inflation should be limited by declining energy prices and ample manufacturing capacity. Domestically, manufacturing capacity utilization was at 77% this spring, which is well below the 82.0% threshold that usually signals building cost pressure. This condition was echoed overseas for a range of basic industries—metals, chemicals, autos, and paper—leaving plenty of room for growth without the danger of sparking inflation. Consumer inflation should also moderate over the near term. The forecast is for 3.4% consumer inflation in 2001, the same as last year. This stability in the year-to-year numbers, however, masks a deceleration in the CPI from a 4.2% annual rate at the beginning of 2001 to an annual rate of 2.2% at the end of that same year. Beyond 2001, consumer inflation should continue to trend gradually lower. Specifically, consumer price inflation is projected to be 2.5% in 2002, 2.4% in 2004, and 2.3% in 2004. The combination of lower energy prices and higher unemployment are the chief factors in the deceleration of the CPI over the near term. Lower energy costs have their biggest impact over the next four quarters. Smaller increases in employee compensation, reflecting the slackening labor markets, help to limit increases in the service components of the CPI, and serve to bring down the inflation forecast in late 2002 and 2003.



Employment: The tightest labor market in three decades should slacken over the next few years. The U.S. civilian unemployment rate dipped just below 4.0% in the last quarter of 2000. This marks the nadir of a trend that has seen the unemployment rate decline since the beginning of 1993. The last time the unemployment rate fell below 4.0% was at the end of 1969. During the 1990s the labor market passed a few mileposts that are worth reviewing. One of the unique features about the recovery from the 1990-91 recession was the slow job growth. It took over three years for the unemployment rate to drop to 6.0%, the level that was considered close to full employment at that time. It would take another two years, until 1996, to drop this measure back to its pre-recession level of around 5.3%. After this slow start, the employment picture continued to improve. By the end of 1997, the civilian unemployment rate was just under 5.0%. Many felt that at this level wages would start rising, and this would fuel higher inflation. A year later the unemployment rate had



fallen further to 4.4%, well below almost everyone's estimate of full employment. In spite of this, inflation remained tame. The unemployment rate declined another 50 basis point over the course of 1999. And by the end of last year it was below 4.0%. The increase in the number of jobs in the 1990s also attests to the strength of the employment sector. Since the end of the 1990-91 recession, the number of jobs has grown an average of 2.2% per year.



Business Investment: For the first time in several years, real investment growth is expected to trail overall economic growth. This marks a major reversal for this important sector. In a short period of time business investment has gone from being an important engine of economic expansion to a drag on the economy. Real nonresidential fixed investment grew significantly faster than real GDP in every year from 1992 to 2000. By 1998, real business investment growth was nearly three times as fast as real GDP. Fueling this growth was the investment in high-tech equipment. From 1991 to 2000, real investment in communications equipment expanded by nearly 14.0% annually. Real spending on software by businesses increased 18.0% per year. But these figures pale in comparison to investment in computer equipment, which grew 39.3% per year over the same period. Several factors account for this stellar growth. First, intense competitive pressures forced American businesses to invest in new technologies in order to raise productivity. Second, a tightening labor market forced companies to replace labor with capital. Third, a flood of new technologies shortened the life cycle of many existing products, requiring constant investment in order to be at the state of the art. Fourth, technology had to make up for shortness of skills in the labor force. Fifth, low interest rates increased the affordability of these investments. The momentum from nine years of strong growth is hard to control, so it is no surprise that high-tech investment over ran its headlights when the economy began to slow. Nominal investment in software, computer equipment, and communication equipment has plummeted, posting two straight quarters of decline. This has caused inventories to swell. This spring the manufacturers' inventory-to-shipments ratio stood at 2.2, which was well above last April's ratio of 1.4. To get the inventory-to-shipments ratio back down, manufacturers must cut production, write off billions of dollars of inventories, and endure dismal profits. The economy is expected to pick up speed in 2002. While this eventually should stimulate real business investment, a return to the 1990's boom condition is not anticipated. After rising nearly 13.0% in 2000, real business investment is projected to increase less than 1.0% in 2001, decline 0.1% in 2002, rise 6.4% in 2003, and advance 6.1% in 2004.